IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

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| WRS, INC., d/b/a WRS MOTION PICTURE LABORATORIES, a corporation, | CIVIL ACTION |
| | No. 00-2041 |
| Plaintiff, | |
| vs. | |
| PLAZA ENTERTAINMENT, INC., a corporation, ERIC PARKINSON, an individual, CHARLES von BERNUTH, an individual and JOHN HERKLOTZ, an individual, | |
| Defendants. | |

**BRIEF IN OPPOSITION TO MOTION FOR SUMMARY JUDGMENT OR, ALTERNATIVELY, MOTION FOR PARTIAL SUMMARY JUDGMENT FILED BY DEFENDANT, JOHN HERKLOTZ**

Plaintiff, WRS, Inc. (hereinafter referred to as "WRS") sued Plaza Entertainment, Inc. (hereinafter referred to as "Plaza") for the balance due on its account for the duplication of videocassettes. WRS sued John Herklotz (hereinafter referred to as "Herklotz"), Eric Parkinson (hereinafter referred to as "Parkinson") and Charles von Bernuth (hereinafter referred to as "von Bernuth") on their personal guaranties of the debt of Plaza to WRS. Herklotz has moved for Summary Judgment claiming that his liability as guarantor was discharged by a "Services Agreement" dated October 12, 1998, pursuant to which WRS undertook the task of billing Plaza's customers and collecting through a lock box Plaza's receivables. Herklotz also argues that WRS's records pertaining to its account are not sufficiently reliable to support a claim for damages.

WRS respectfully submits that Herklotz's arguments are without merit and his Motion for Summary Judgment should be denied. Furthermore, because the law and the facts admitted as true by Herklotz establish his liability to WRS, Judgment should be entered in favor of WRS and against Herklotz, at least as to liability.

## FACTUAL BACKGROUND

Since at least 1959 WRS has been engaged in providing services to the film and, subsequently, video industry (Napor Deposition, Page 12) (Portions of the Napor deposition are filed as Exhibit "1" in conjunction with this Brief.) Prior to 1996, WRS manufactured dubs of videocassettes for Hemdale Entertainment of which Parkinson was president (Napor Deposition, Pages 58 – 67). In 1996, Parkinson introduced his new venture, Plaza, to WRS and began ordering the manufacturing videocassettes (Napor Deposition, Pages 68 - 69). By April 30, 1998, Plaza was indebted to WRS on its open account in the sum of $168,031.02 (Napor Affidavit in Opposition to Herklotz's Motion for Summary Judgment (hereinafter referred to as "Napor Affidavit" filed as Exhibit"2" with this Brief). Of this amount of $13,660.50 was accrued finance charges calculated at 1.5% per month. (See Terms on invoices identified as Herklotz's Exhibits "B" and "C" to Motion for Summary Judgment)

In late April of 1998, Parkinson, for Plaza, submitted orders to WRS for the duplication of videocassettes for the film entitled "Giant of Thunder Mountain" (hereinafter referred to as "GTM") (Napor Deposition, Page 76) (Napor Affidavit). Because the request would entail a substantial increase in credit WRS would have to extend to Plaza, WRS sought to formalize its account relationship with Plaza and to secure a personal guaranty (Napor Deposition, Pages 73 – 75).

At that time, Herklotz was the CEO of Plaza (Herklotz Answer, Paragraph 8). Herklotz was also the producer of and had a personal financial interest in the film GTM (Napor Deposition, Page 88). In early May 1998, Parkinson and von Bernuth told Herklotz that Plaza had obtained a large order for GTM videos from Wal-Mart and in order to fulfill the order WRS required Herklotz's personal guaranty. (Herklotz Cross Claim Count V, Paragraph 2). (Pertinent portions of the Pleadings are attached as Exhibit "3" filed in conjunction with the Brief). On May 6 1998, John Purdy of WRS faxed to Parkinson the WRS Credit Application (Napor Affidavit) and the blank form Guaranty to Herklotz (Napor Affidavit). Herklotz immediately signed the Guaranty and returned it to WRS (Napor Affidavit) (Herklotz Answer, Paragraph 8). Parkinson, however, delayed in returning the Credit Application until July of 1998 (Napor Deposition, Pages 72 – 73). However, in reliance upon Herklotz's Guaranty, WRS filled the Plaza order for videocassettes of GTM and, otherwise, continued to do business with Plaza (Napor Deposition, Pages 90 – 96,, 175-177).

By letter of August 28, 1998 (Napor Affidavit), Parkinson sent a letter concerning its potential problem in paying for the GTM duplication proposing the following:

> At one point in time, Joe, there was a discussion regarding the possibility of WRS providing a service of invoicing and collecting on orders that WRS is already manufacturing and shipping for Plaza. Perhaps it is time to resurrect these discussions for the reasons that are now obvious: Plaza is not doing a good job of collection and WRS may need a better form of collateral."

Following the letter, WRS prepared a draft of the Service Agreement and sent it for comment to Parkinson and Parkinson responded with corrections acknowledging that WRS's records reflected Plaza's debt to WRS as of August 31, 1998 to be the sum of $635,379.86. Parkinson, however contended that Plaza was entitled some credits against that amount. The Napor Affidavit shows that as of August 31, 1998 the WRS accounts receivable aging report for Plaza shows an outstanding balance in the sum of $720,679.15 of which $35,299.29 consists of finance charges. When the finance charge is subtracted, the amount shown on WRS's accounts receivable aging report as of August 31, 1998 is the sum of $635,379.86

corresponding with the amount acknowledges by Parkinson in is comments pertaining to the Interim Agreement and the amount shown on the Services Agreement due and owing as of August 31, 1998.

Negotiation of the terms of the Services Agreement continued until October 12, 1998, at which time the Services Agreement was executed. After the execution of the Services Agreement, WRS took over the billing and collection of receivables and set a lock box account. Unfortunately, the receivables that Plaza purported to have were difficult, if not impossible, to collect (Napor Deposition, Pages 121 – 123). Ultimately, the relationship between WRS and Plaza ended. Despite discussions regarding the potential for payment of the receivables, WRS commenced this action.

WRS's Complaint refers to the amount due and owing by Plaza as of June 30, 2000. The Napor Affidavit refers to the account receivable aging report of June 30, 2000 and shows the amount due as of the date as $1,297,747.23. The Napor Affidavit indicates that sum had credited against it an NSF check in the sum of $40,000.00, which when added increases the balance to $1,337,747.23. As of June 30, 2000, WRS had performed the Services Agreement for 14 months at $5,000.00 a month for an additional $80,000.00, bringing the amount due and owing to the sum of $1,417,747.23 as of June 30, 2000, essentially the amount for which suit was brought. Since that date, finance charges according to the terms of each invoice and attorney's fees have accrued, which are payable both under the Herklotz Guaranty and the terms and conditions of the Credit Application submitted by Parkinson and the personal guaranties of Parkinson and von Bernuth found in the Services Agreement. Complaint Exhibit "A" and "B."

## ARGUMENT

### Herklotz's Obligation To WRS Was Not Discharged By The Services Agreement.

In considering a Motion for Summary Judgment, the Court must view the facts in a light most favorable to the non-moving party. Doe v. County of Centre, 242 Fed.3rd 437 (3rd Circuit 2001). Summary Judgment may be appropriately entered only where there is no genuine issue of material facts and the moving party is entitled to Judgment as a matter of law. F.R.C.P. 56(c); Celotex Corp. v. Catrett, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed 2nd 265 (1986). Where the appropriate record exists, the Court may not only deny the moving party's Motion for Summary Judgment, but may also enter Judgment for the non-moving party. CW Gov't Travel, Inc. v. United States, 63 Fed. Cl. 459; (2005). WRS respectfully submits that not only should Herklotz's Motion be denied, but also that Judgment should be entered in favor of WRS and against Herklotz for, at a minimum, liability.

Herklotz correctly points out that because the document he signed does not contain the language prescribed by 8 P.S. §1, he is a surety directly liable to WRS for the Plaza debt rather than a guarantor. Herklotz claims that he was not aware of the services agreement. There is no evidence in the record that he knew of the services agreement other than to the extent that Parkinson's and von Bernuth's knowledge of it is imputed to Herklotz. The obligation of the surety is discharged by a material modification of the debtor/creditor relationship to which the surety did not consent. Continental Bank v. Axler, 353 Pa.Super 409, 510 A.2d 726 (1986). Schroyer v. Thompson, 262 Pa.Super 282, 105 A.2d 274 (1918) However, assuming his lack of knowledge, the issue is whether under the document he signed, Herklotz consented to material modifications of the creditor/debtor relationship such that his promise to pay the Plaza debt was unaffected notwithstanding the change in the WRS /Plaza relationship. Meeting House Lane, Ltd. v. Melso, 427 Pa.Super 118, 628 A.2d 854 (1993).

In interpreting the Herklotz guaranty, the rules of construction differ depending on whether Herklotz is considered a gratuitous surety or a compensated surety. When determining whether the gratuitous surety consented to modification in the language of the contract of surety, the terms of the contract are strictly construed in favor of the surety. Manufacturers & Merchants Bldg. & Loan Ass'n v. Willey, 321 Pa. 340, 183 A. 789 (1936). . Where a surety is a compensated surety, the surety agreement is construed in favor of the obligee (here "WRS'). Fiurama v. American Surety Co., 346 Pa. 584, 31 A.2d 283 (1943); Garden State Tanning, Inc. v. Mitchell MFG Group, Inc., 273 Fed.3rd 332 (3rd Circuit 2001). The court when interpreting the commitment of a compensated surety the court may construe the agreement in favor of the oblige beyond the precise terms of the contract. Wise Inv. v. Bracy Contr Inc., 232 Fed.2d 390 (E.d. Pa 2002).

Thus, in determining whether Herklotz consented to the modification of the debtor/creditor relationship by executing the guaranty document, if Herklotz, is a gratuitous surety the terms of the contract are construed strictly in his favor. Barrat v. Greenfield, 137 Pa.Super 310, 9 A.2d 188 (1939). However, if Herklotz is a compensated surety, the language of his guaranty is construed n favor of WRS.

A professional surety company is considered a compensated surety because it obtains a fee for its services. Bank of Nova Scotia v. St. Croix Drive In Theatre Services, 728 F.2d 177 (3rd Circuit 1984). However, Pennsylvania law does not limit compensated sureties to professional surety companies. An officer or sole shareholder of a corporation who provides a guaranty to induce a creditor to extend a line of credit is considered a compensated surety. First National Bank of East Conenaugh v. Davies, 315 Pa. 59, 172 A.2d 296 (1934). Similarly, other officers and directors, who are otherwise interested in the transaction, are also considered compensated sureties. In Re: Cancelmo, 308 Pa.128, 162 A 454 (1932); J.F. Walker Co., Inc. v. Excalibur Oil Group, 2002 Pa.Super 39, 792 A.2d 1269 (2002). The trend as recognized by Third Circuit is away from the application of the strict construction in favor of the surety where the surety is motivated by potential profit in giving his guaranty.

Garden State Tanning, Inc. v. Mitchell Manufacturing Group, Inc. s*upra*. More recently, the trend was recognized in Pennsylvania Superior Court in Fessenden Hal of PA v. Mountainview Specialties, Inc., 2004 Pa.Super 456, 863 A.2d 578 (2004) where the Court found an individual without whose guaranty the creditor would not have extended credit to be compensated surety which holding was in accord with McIntyre Square Associates v. Evans, 2003 Pa.Super 214, 822 A.2d 446 (2003) and J.F. Walker *supra*.

Here, Herklotz had a personal financial interest in GTM. He was advised by Parkinson and von Bernuth that WRS would not manufacture the dubs of GTM without Herklotz's personal guaranty. At some point during these transactions, Herklotz was the CEO of Plaza. Clearly, Herklotz did not provide his Guaranty out the familial or neighborly affection mentioned in Garden State Tanning *supra*. Rather, Herklotz was motivated to provide a Guaranty in order to sell cassettes of his film. In fact, Herklotz has asserted a Cross Claim against Parkinson and von Bernuth for the loss incurred by their mishandling of the sales of GTM videos by failing to properly advertise and promote the sale of the videos. Thus, Herklotz was a compensated surety. In determining whether by signing the guaranty document Herklotz consented to material modification of the Plaza/WRS relationship, the Court must construe the language in favor of WRS. Central-Penn National Bank of Philadelphia v. Tinkler, 351 Pa. 123, 4 A.2d 389 (1945); Restatement of Security Session 128 Comment C.

It should be pointed out, however, that even if Herklotz was a gratuitous surety, he could execute a document that sufficiently expressed consent to modifications. Reliance Insurance Company v. Penn Paving Company, Inc., 557 Pa. 439, 734 A.2d 833 (1999); Robert Mallery Lumber Corp v. B & F Associates, Inc., 294 Pa.Super 503, 440 A.2d 579 (1982). Thus, even if Herklotz is considered not to be a "compensated guarantor", interpreting the Guaranty Agreement to determine Herklotz's intention, clearly reveals his consent to subsequent modifications of the creditor/debtor relationship whether construed in favor of WRS or strictly construed in favor of Herklotz.

The document Herklotz signed establishes his unconditional and continuing commitment to be continuously and directly liable to WRS for the Plaza debt regardless of extensions and modifications and regardless of whether he was given notice of any changes with his liability to conclude when he chose to terminate his liability by providing notice. The document begins with the following phrase:

> To induce you to sell merchandise and to extend credit to debtor… unconditionally guaranties complete and prompt payment when due of any indebtedness, which may at the present time or at any time hereafter and from time to time be owing to you by debtor.

The language continues:

> This guaranty is direct and unconditional and may be enforced without first resort to any other right, remedy or security, which you have. The undersigned waives notice of acceptance hereof all prior notice of default and a demand for payment.
>
> You shall have the unrestricted right to renew, extend, modify and/or compromise any indebtedness and to accept, substitute, surrender or otherwise deal with any collateral, security or other guaranties without notice to the undersigned and without effecting the obligation of the undersigned hereunder.
>
> This guaranty shall continue at all times and shall remain in full force and effect until such time as you receive from the undersigned by registered mail written notification of revocation.

The language in the Herklotz document contemplated an ongoing relationship during which WRS in reliance upon his guaranty would sell merchandise and/or extend credit to Plaza. The language anticipated extensions and modifications of the debtor/credit relationship to which Herklotz agreed could take place without restriction or notice to him and without affecting his liability. WRS, therefore, respectfully submits that to the extent that the Services Agreement materially modified the relationship between WRS and Plaza (which WRS argues was not materially modified) Herklotz consented to such modification by the Guaranty delivered to WRS. Therefore, the fact that the Services Agreement may have modified the relationship between WRS and Plaza does not serve to discharge Herklotz's liability.

Furthermore, even if the Court were to find the guaranty did not contain Herklotz's consent to the modification without notice of the creditor/debtor relationship between WRS and Plaza, the Services Agreement did not materially modify the Plaza/WRS relationship contemplated by the Herklotz Guaranty.

As can be seen by the language of the Guaranty, Herklotz contemplated an ongoing account relationship consisting of both present and future indebtedness. The document was not limited in any way to the expense of duplicating the video of GTM, although Herklotz certainly knew before signing that those duplications would not be manufactured without his Guaranty. Because Herklotz had the opportunity to limit his obligation when he submitted the signed document and did not take that opportunity to do so, Herklotz is bound by the document he signed. Denlinger v. Dendler, 415 Pa.Super 164, 608 A.2d 1065 (1992).

For there to be a material modification in the debtor/creditor relationship requires an agreement substantially different from the original agreement for which this surety accepted liability. J.F. Walker Company, Inc. v. Excalibur Oil Group, *supra.* This begs the question: Of what agreement did Herklotz accept liability? From the Guaranty signed, it was an open account arrangement in which WRS would manufacture video to be paid for by Plaza from funds earned through the sale of the videos, which sales would be enhanced by Plaza. As can be seen from Parkinson's August 28, 1998 letter, the Services Agreement simply transferred the billing and collection function from Plaza to WRS and provided a mechanism to assure payment to WRS on the debt that Herklotz agreed to pay. Napor similarly characterized the arrangement in his deposition testimony at stating,

Q. There was a situation where WRS apparently determined that Plaza was incapable of collecting that receivable and managing the distribution process?

A. No, that's not correct. Plaza for whatever reason wasn't doing it and whatever money was going into Plaza wasn't getting distributed as it should have been, a big chunk of it to pay us for dubs, and even so Plaza was failing. They had an infrastructure, a bunch of people, I don't remember how many, seven of eight people rented off space and they were doing these things which contributed to their overhead and they weren't able to cover the cost of their overhead. They were using some of the money that they could have been paying us and other creditors with just to cover costs , and at some point Parkinson realized that they weren't doing and effective job themselves and they couldn't cover these costs anymore, and that is the basis we were talking about , how can we cut costs, how can we get some money back in. That's what happened. (Napor Depo P.150.

WRS submits that the arrangement under the services agreement did not materially modify the debtor/creditor relationship and did not discharge Herklotz even as a gratuitous surety. However, because of Herklotz's was a compensated guarantor, Herklotz obligation would not be discharged absent a showing that she services agreement substantially increased Herklotz's risk as a guarantor. McClelland v. New Amsterdam Casualty Company, 322 Pa. 429, 185 A. 198 (1936); Continental Bank v. Axler, *supra*.

While Herklotz argues that the Services Agreement increased his risk, this is at a minimum a genuine issue of material facts prohibiting the entry of Summary Judgment. Furthermore, a review of the Services Agreement, WRS submits, demonstrates that Herklotz's risk was not increased from that contemplated. Herklotz guaranty contemplated an ongoing account relationship. The Services Agreement reduced Herklotz's risk by providing collateral and providing a mechanism to assure application of payment to the debt that he guarantied and by adding as guarantors Parkinson and von Bernuth (against who Herklotz has now maintained his Cross Claim for contribution). The Services Agreement also provided an incentive in reduction of the outstanding debt if Plaza became current in its receivables. Based upon a review of the Services Agreement, WRS submits that the Services Agreement substantially reduced Herklotz's risk. Herklotz has failed to demonstrate that the Services Agreement in any way increased his risk. Thus, even Herklotz is found not to have consented to material modifications by signing the guaranty, since his risk was not increased by the services agreement, his liability as a surety has not been discharged.

In Summary, Herklotz's obligation as surety has not been discharged. Rather, he remains liable to WRS for the full amount of the outstanding obligation of Plaza. Not only should Herklotz's Motion for Summary Judgment be denied, but the Court should enter Judgment for liability in favor of WRS and against Herklotz.

## ARGUMENT II

### WRS Has Reliable Admissible Business Records That Conclusively Establish The Amount Of Plaza's Debt And Herklotz's Obligation.

During his deposition, Jack Napor was unable to immediately recall to memory from the volume of documents produced by WRS records to establish Plaza's debt. However, the Napor Affidavit establishes that the information contained in the aged trial balance referred to in the Napor Deposition, Page 209, included in the Affidavit, was a record of a regularly conducted business activity that the invoices generated were placed on the system at any other times the invoices created and payments registered to the system when payments were received.

As evidence of the accuracy of the information, WRS points to the Services Agreement and the Interim Agreement exchanged with Parkinson in October of 1998 where reference is made to the balance of the account being $685,379.86 as of August 31, 1998. As pointed out above, when the finance charges are removed from the aged trial balanced the sum demonstrates that, in fact, the balance due on the account as of August 31, 1998 was $685,379.86 as shown in the Services Agreement. Similarly, the accounts receivable aging report of June 30, 2000 conforms to the amount set forth in Plaintiff's Complaint. Therefore, the records kept in the usual course of business of WRS sufficiently establish the amount due.

In this action for breach of Herklotz's contract of guaranty, where the sole basis for the Motion for Summary Judgment is the absence of provable damages, the motion must be denied since nominal damages could be awarded at trial. Thorson v. Iron and Glass Bank, 328 Pa.Super 135, 426 A.2d 928 (1980); Sonfast Corp. v. York Int'l Group, 875 F. Supp. 1088 (MD Pa.1994). WRS's burden is to offer proof of its damages with reasonable certainty. A&B Tanner Co., Inc. v. WIOO, Inc., 528 F.2nd 271 (3rd Circuit 1975). All that WRS must do is offer proof that would provide a reasonable basis for the trier of fact to calculate damages and to arrive at an intelligent estimate of WRS's loss without conjecture. Delehanty v. First Pennsylvania Bank, N.A., 318 Pa.Super 90, 464 A.2d 1243 (1983). WRS is not endeavoring to prove lost profits, which may be denied if evidence is too speculative. Bolus v. United Penn Bank, 363 Pa.Super 247, 525 A.2d 1215 (1987). Rather, WRS's damages consist of four components:

1. A total amount of unpaid invoices for goods manufactured at Plaza's request;
2. The interest due on the unpaid invoices;
3. $5,000.00 a month fee under the Services Agreement; and
4. Attorney's Fees.

WRS submits that it has demonstrated sufficient proof of damages based upon the records of its regular business activity kept in the ordinary course and daily course of its business pursuant to F.R.C.P. 803 (6).

Furthermore, the Credit Application executed by Parkinson on behalf of Plaza contained the following language:

> We have read and agree to be bound by the terms and conditions included as part of this Application. I agree that all credit granted pursuant to this Application shall be bound by these terms and conditions.

With respect to payment of invoices, the terms and conditions (Exhibit A to Plaintiff's Complaint state:

> Any claims that the customer may have against the company for adjustment or which in any way would effect any invoices must be presented to the company in writing no later than thirty days from the date of the invoice must be presented to the company in writing no later than 30 days from the date of the invoice in question. Customer hereby irrevocably waives any claim for adjustment or change or modification in any such invoice in which such claim is not presented in writing to company within the 30 days.

The account balance due WRS is made up of unpaid invoices sent to Plaza for payment. If not disputed within 30 days, those invoices are deemed undisputed. WRS submits that each invoice submitted after which no objection or adjustment has been demonstrated in writing constitutes an account stated the result of which is to render Plaza liable for the amounts due in absence of clear and convincing evidence of fraud or mistake. Mahoney Trustee v. Boenning, 335 Pa. 210, 6 A.2d 793 (1939).

More significantly, Herklotz, executed an unconditional guaranty which deprives him of various defenses that he might otherwise have had against payment of the debt. For example, the failure of WRS to collect accounts receivable in which the debt can be paid is not a defense to liability of an unconditional guarantor. McKeesport National Bank v. Rosenthal, 355 Pa.Super 291, 513 A.2d 434 (1986) An unconditional guarantor is bund by the commitments of the debtor. CitiCorp N.A. v. Thorton, ___Pa.Super___, 707 A.2d 536 (1998). Nor is an unconditional guarantor's debt excused by the creditor's failure to perfect a security interest. Fireman's Fund v. Joseph J. Biafore, Inc., 526 F.2d 170 (3rd Circuit 1975). The effect of the unconditional guaranty is to limit the guarantor's defenses to payment or performance. Continental Leasing v. Libo, 272 A.2d 193, Pa.Super (1970). By committing unconditionally to repay Plaza's debt and since Plaza has bound itself to the liability for the outstanding invoices pursuant to the terms and conditions incorporated into the credit application, Herklotz cannot now question the validity of those records. Herklotz's only defense would be to show that the invoices for which WRS seeks payment have been paid. Unfortunately, payment is an affirmative defense, which Herklotz has not plead. F.R.C.P. 8(c). As a result, he has waived the defense of payment and cannot assert the same. Prinz v. Greate Bay Casino Corp., 705 F.2d 692 (3rd Circuit 1983). Thus, because Herklotz has not averred that the debt in which WRS seeks payment has been paid, as an unconditional guarantor, Herklotz has no defense to the claim and no right to dispute the debt evidenced by the business records of WRS.

## CONCLUSION

In light of the foregoing, Herklotz has promised to be continuously, unconditionally and directly liable to WRS for the indebtedness of Plaza. By unconditionally guarantying the debt, Herklotz bound himself to pay the obligation notwithstanding relationship between WRS and Plaza. For these reasons, WRS respectfully submits that not only should the Motion for Summary Judgment be denied, but that the Court should enter Summary Judgment in favor of WRS and against Herklotz as to liability.

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**CERTIFICATE OF SERVICE**

I, Thomas E. Reilly, Esquire, hereby certify that a true and correct copy of the Brief in Opposition to Motion for Summary Judgment or, Alternatively, Motion for Partial Summary Judgment was delivered via first-class mail, postage pre-paid on the __7th__ day of __March_, 2006 to the following:

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